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October 7, 2005

VIA COURIER DELIVERY

Mr. Andy Pollock
Executive Director
Nebraska Public Service Commission
300 The Atrium
1200 "N" Street
Lincoln, NE 68509-4927

Re: Initial Brief of Aquila, Inc. d/b/a Aquila Networks in
Support of Limited Cost Recovery
Application No. NG-0031

Dear Mr. Pollock:

Enclosed for filing in the above-referenced case is the original and eight (8) copies of an *Initial Brief of Aquila, Inc. d/b/a Aquila Networks in Support of Limited Cost Recovery*. Please file stamp the extra copy and return same to my office in the enclosed self-addressed stamped envelope.

If you have any questions or concerns regarding the enclosed filing, please contact me at your earliest convenience.

Sincerely,



Douglas J. Law

DJL/lw
Enclosures

OM-205380-1

KANSAS CITY, MISSOURI • ST. LOUIS, MISSOURI • OVERLAND PARK, KANSAS • OMAHA, NEBRASKA
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BEFORE THE PUBLIC SERVICE COMMISSION OF NEBRASKA

In the Matter of Aquila, Inc. d/b/a Aquila)	Application No. NG-0031
Networks (Aquila), seeking authority for Limited)	
Cost Recovery in the State of Nebraska)	
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**INITIAL BRIEF OF AQUILA, INC. d/b/a AQUILA NETWORKS
IN SUPPORT OF LIMITED COST RECOVERY**

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Dated: October 7, 2005

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**BRIEF OF AQUILA, INC. d/b/a AQUILA NETWORKS
IN SUPPORT OF LIMITED COST RECOVERY**

Aquila, Inc. d/b/a Aquila Networks (“Aquila”) hereby submits this brief pursuant to Commission’s Procedural Order Entered September 9, 2005 wherein Aquila was permitted to file its legal and policy argument in support of its filing. Aquila reaffirms its request for its Limited Cost Recovery (LCR) application under both legal and policy grounds.

INTRODUCTION AND PROCEDURAL BACKGROUND

On August 1, 2005 Aquila filed an application under provisions of the State Natural Gas Regulation Act (“Act”) seeking limited cost recovery in the State of Nebraska.¹

Notice of Aquila’s application was published in *The Daily Record*, Omaha, on August 2, 2005. On August 23, 2005, Cornerstone Energy filed a Petition for Formal Intervention. On August 26, 2005, the Public Advocate filed a timely Petition for Formal Intervention in this matter. The Public Advocate further requested that to the extent Aquila’s application is a change in its tariffs, that the operation of the changed tariff be suspended pending the outcome of any hearing. Those Formal Interventions were granted by Commission Order entered on September 7, 2005 in this proceeding.

¹ Prior to August 1, 2005, Aquila engaged in general informal meetings with various parties, Commission Staff and the Public Advocate seeking guidance, feedback, and concerns regarding its Limited Cost Recovery filing.

A planning conference was first held in this matter on August 8, 2005 at 1:30 a.m. at the Commission, 300 The Atrium, 1200 N Street, Lincoln, Nebraska, via teleconference. As a result of the planning conference, a discovery schedule was set and a hearing scheduled. The Public Advocate, Cornerstone, and Aquila are permitted to file Initial Briefs on or before October 7, 2005 on the policy and law regarding Aquila's LCR application. Each party was provided an opportunity to file reply briefs on or before October 17, 2005.

A Protective Order was issued in this proceeding by Commission Order entered September 21, 2005.

Oral argument in this proceeding is set for October 19, 2005 at 1:30 p.m. in the Commission Hearing Room, 300 The Atrium, 1200 N Street, Lincoln, Nebraska.

This Brief is submitted pursuant to the above-stated order.

POINTS OF LAW AND SUMMARY OF ARGUMENT

Aquila requests that the Commission approve its request for limited cost recovery in the state of Nebraska. The reasons can be summarized simply as follows:

- The State Natural Gas Regulation Act, Neb. Rev. Stat. §§ 66-1804 et seq. (2003) gives the *Commission full power, authority, and jurisdiction to do all things necessary and convenient* for the exercise of such power to regulate natural gas public utilities. Neb. Rev. Stat. § 66-1804(1) (2003) (emphasis added).
- The State Natural Gas Regulation Act and *all grants of power, authority, and jurisdiction in the act made to the commission shall be liberally construed, and all incidental powers necessary to carry into effect the provisions of the act are expressly granted to and conferred upon the commission.* Neb. Rev. Stat. § 66-1804(2) (2003) (emphasis added).

- The Commission may adopt and promulgate rules and regulations to govern the mode and manner of its proceedings, including but not limited to, procedures and requirements of applications for rate and tariff changes. Neb. Rev. Stat. § 66-1805 (2003).
- Under the State Natural Gas Regulation Act, the term “**General rate filing**” means any filing which requests changes in **overall revenue requirements** for a jurisdictional utility. Neb. Rev. Stat. § 66-1801(6) (2003) (emphasis added).
- Under the Act, the term “**Rate**” means *every compensation, charge, fare, toll, tariff, rental, and classification, or any of them, demanded, observed, charged, or collected by any jurisdictional utility for any service*. Neb. Rev. Stat. § 66-1801(12) (2003) (emphasis added). Rate changes are not limited under the act to only “General rate filings.”
- Section 66-1808 of the Act grants authority to the Commission to permit changes in *rates, or any term or condition of service pertaining to the service or rates of such utility*. The Commission shall not delay the effective date of a proposed change in rates or any term or condition of service pertaining to the service or rates of any jurisdictional utility, more than one hundred eighty days beyond the date of filing. Neb. Rev. Stat. § 66-1808 (2003) (emphasis added).
- The provisions authorizing review of rate changes in section 66-1808 do not apply to General rate filings. Neb. Rev. Stat. § 66-1808(1) (2003).
- Section 66-1809 of the Act grants the Commission authority, upon its own initiative, to investigate all schedules of rates, contracts, and terms and conditions of service of jurisdictional utilities. This investigation is not part of and is outside the procedures

of a General rate filing and is not subject to the requirements of section 66-1838 of the Act.

- Section 66-1825 of the Act sets forth requirements for natural gas rates of a jurisdictional utility. That section of the Act does not mandate a General rate filing for implementation of those requirements. Nor does section 66-1825 limit application of those requirements only to a General rate filing. Those requirements can be applied to other rate changes.
- ***The requirements of Section 66-1838 of the Act apply only to General rate filings.*** Neb. Rev. Stat. § 66-1838 (2003) (emphasis added). The provisions of that section relate to changes in overall revenue requirements for a jurisdictional utility. The limited cost recovery sought by Aquila is not intended as a General rate filing requiring an all inclusive review of revenues and expenses. Instead, it is a change in rates, i.e., customer change, that results in limited recovery of costs.
- The State Natural Gas Regulation Act provides in ***section 66-1855 that the commission may authorize, consistent with general regulatory principles, including, but not limited to*** (1) banded rates with a minimum and maximum rate that allows the jurisdictional utility to offer ratepayers rates within the rate band for the purpose of attracting additional natural gas service demand or to retain such demand, (2) mechanisms for the determination of rates by negotiation, and (3) customer choice and other programs to be offered by a natural gas public utility to unbundled one or more elements of the service provided by the utility. Neb. Rev. Stat. § 66-1855 (2003) (emphasis added). This section does not limit the types of alternative ratemaking filings that a jurisdictional utility may present or that the

Commission may approve to only those resulting from a General rate filing. In fact, it authorizes the Commission to approve a variety of different rate methods so long as those methods are consistent with “general regulatory principles.” Aquila’s LCR filing is intended as an alternate rate making filing, and is consistent with general regulatory principles.

- In addition to the State Natural Gas Regulation Act, Aquila’s Limited Cost Recovery application should be approved on policy grounds. This LCR, as would be the case for any future LCR filing, is intended to benefit all parties. As stated in the LCR application, the purpose of an LCR is to avoid the time and expense of all parties required under General rate filing statutes. The Act provides for alternative rate making ability authority for actions other than a full blown rate proceeding. Aquila’s application for limited cost recovery fall squarely within that authority.
- Some of the benefits identified for approval of an LCR versus a General rate filing were set forth on page 4 of Aquila’s LCR application. Those reasons are adopted and incorporated by reference here. The LCR application includes the following reasons supporting LCRs: (1) smaller increases under an LCR than a General rate filing, (2) potentially lower regulatory and litigation costs to attain just and reasonable rates, (3) more timely recovery of increased rates, which could lead to less frequent or longer periods between General rate filings, (4) potential reduction in the level of request under an LCR, and (5) assisting Aquila in becoming more competitive with its government owned and operated utility competitors who are not subject to the same regulatory burdens and review imposed upon jurisdictional utilities in Nebraska.

- Approval of an LCR can result in just and reasonable rates without violating the Act.

No General rate filing is mandated by the Act to process an LCR request.

ARGUMENT

I. NEBRASKA LAW PERMITS LIMITED COST RECOVERY

Issue: The basic issue for the Commission to decide as a matter of law and policy is whether any rate review that results in a revenue increase must follow the General rate filing procedures set forth in section 66-1838 of the Act.

Aquila takes that position that the Commission has ample authority under the Act to review Aquila's LCR application, and can do so outside of the General rate filing requirements.

As noted above, numerous provisions contained in the State Natural Gas Regulation Act provide the Commission with broad authority to ensure that the natural gas rates of a jurisdictional utility are just and reasonable. *See, e.g.*, Neb. Rev. Stat. § 66-1804, 66-1808, 66-1825 and 66-1855. To argue that the only regulatory review process for arriving at that determination must be a General rate filing would mean to ignore the extensive Commission rate setting and review authority, which must be construed liberally, that is granted elsewhere in the act.

Aquila does not argue that if it pursued a General rate filing wherein it was requesting a change in its overall revenue requirements that it could avoid the requirements set forth in section 66-1838 of the Act. Under those circumstances, Aquila would comply with the more extensive notice and timing requirements established by that statute and Commission regulations. However, Aquila's LCR application states specifically that it is not intended to be a General rate filing request.

Aquila's LCR application would be accomplished by increasing the Customer Charge for all of its regulated customers by approximately \$.47 cents per customer per month or less than \$6.00 per customer per year. The total amount resulting from the LCR rate change by Aquila through its LCR application is not the full amount of recovery that Aquila would request, and most likely be granted, under a General rate filing seeking a change of its "overall revenue requirements." Instead, the LCR application is intended as an alternative method of rate making authorized under the Commission's power pursuant to section 66-1855 wherein the *"Commission may authorize, consistent with general regulatory principles, including but not limited to"* a variety of rates. See Neb. Rev. Stat. § 66-1855.

Issue: The State Natural Gas Regulation Act authorizes the Commission to follow different processes for General filings and alternative rate making proceedings.

The main point of distinction here is that a General rate filing is more comprehensive and requires a whole lot more time, energy, review, and dedication of resources than is intended under an LCR. The process for General rate filings is set forth by section 66-1838 of the Act. A General rate filing involves the overall revenue requirements and all that entails. It is designed for the Commission to review all of the accounts of a jurisdictional utility to make sure that the rates requested are representative of the cost of providing service. Aquila fully understands that the scope and breadth of that review is necessary for the Commission to fulfill its duties under the act for ensuring just and reasonable rates. The provision of section 66-1838 apply only to General rate filings and do not apply when an application is not a General rate filing.

On the other hand, an LCR is not a General rate filing. An LCR is intended to be a rate mechanism that is more like a rate design change, more like an alternative rate making procedure, and more like a specific rate or tariff change. The scope of review for an LCR

application along with the procedure for granting or denying approval are not the same applied to “General rate filings.” The procedures applied to LCR filings are set forth in section 66-1808 and its requirements. Section 66-1808 of the Act does not apply to General rate filings and does invoke section 66-1838 requirements. This distinction is significant and should not be represented as a distinction without a difference. The two types of proceedings are not the same. Thus, the Act granted the Commission authority to adopt different procedures for the different rate changes.

Undoubtedly, some may argue that any change of a rate, or at least a rate increase, would mean filing a General rate filing. Some may argue that any rate proceeding that alters the revenue, i.e., revenue increases, must follow the procedures for General rate filings. Another argument that may be raised is that Aquila’s LCR is merely an attempt at single, issue rate making. These arguments should not be followed in this case as they would ignore both the Commission’s expansive regulatory authority under the Act and cases in other jurisdictions wherein a utility’s revenues may increase though the filing of application other than a General rate filing.

The Commission has authority to approve new or different rates and services without following a General rate filing procedure. One example of this would be Commission approval of a new tariff service provided by a jurisdictional utility. Under such circumstances, the procedures of section 66-1808 would be followed. If Aquila were to instituted a negotiated rate mechanism, a customer choice program, or some other program to unbundled one or more elements of the service provided by the utility, then the Commission is authorized to approve review and approve those filings without a General rate filing. Neb. Rev. Stat. § 66-1855 (2003).

Aquila fully understands that the Limited Cost Recovery filings are not expressly identified under the State Natural Gas Regulation Act. However, Aquila can and has pointed to numerous statutes under the Act that provide the Commission with broad authority to establish just and reasonable rates. When the Commission is reviewing changes in overall revenue requirements, then it would logically follow the statutory requirements set forth for General rate filings in Neb. Rev. Stat. § 66-1838. However, when it is addressing “Rate” changes, i.e., even those that may have an impact on a jurisdictional utility’s revenues, then it may follow the procedures of Neb. Rev. Stat. § 66-1808.

Aquila’s LCR is not intended to be a General rate filing. However, it recognizes that the Commission may not arrive at the same conclusion. Thus, to provide for additional legal certainty Aquila has requested a determination from the Commission for approval of pursuing an LCR application.

To assist the Commission with its deliberations, this Commission may look to other jurisdictions to see how those commissions handle requests similar to the request made here. Some examples where other Commissions have considered and thereafter allowed rate or revenue changes outside a traditional rate case are summarized below.

II. OTHER STATES SUPPORT REVENUE RECOVERY OUTSIDE OF A RATE CASE PROCEEDING

In addition to the State Natural Gas Regulation Act of Nebraska, Commissions in other states have approved requests of natural gas utilities to establish rates or change an existing rate outside of a rate case. For example, a generic list of different types of proceedings that may permit a utility additional revenue, but not necessarily through a rate case are as follows:

- Demand Reduction Mitigation Strategies

- Weather Normalization Clauses
- Decoupling Tariffs and Margin Recovery Tracker Mechanisms
- Conservation Riders
- Revenue and Return Stabilization Mechanisms
- Expense trackers or Rate Adjustment Mechanisms, including bad debt recovery mechanism, integrity management mechanisms, pipeline replacement programs, and pension recovery charges.

The rationale for approving an alternate rate making mechanism of any type is generally to counter the regulatory lag that is present in traditional rate cases. The Commission is seeking a proper balance between providing rate certainty for the utility while protecting the customers from unjust and unreasonable rates. At the same time, the jurisdictional utility looks for opportunity to balance a number of sometimes competing goals. For example, it must achieve a reasonable return while promoting profitable growth, establish effective management and business practices, achieve operational efficiencies, address customer's energy needs, and generally provide safe and reliable service at just and reasonable rates. Sometimes the types of alternative rate making mechanism are established through a formal rate proceeding, however, in several instances they are not. Further explanation of each type of proceeding is provided below.

Demand Reduction or Energy Efficiency: One example of rate changes that can occur without a rate case is when a Commission permits rate changes resulting from decreased usage of natural gas demand. The reduced demand normally stems from an increase in appliance efficiency. It could result in some service area from a deteriorating population base. In such situations, a Commission may approve a tariff provision or rider that permits recovery costs lost to the utility due to decreased demand. For example, the Iowa Utilities Board permits Energy

Efficiency tariffs. *See, e.g.,* <http://www.state.ia.us/government/com/util/ee.html> for a general description of Iowa Energy Efficiency programs.

Weather Normalization Clauses: A weather normalization adjustment is another example of change in revenue that may occur outside of a traditional rate proceeding. While it is true that weather normalization clauses generally are approved under a traditional rate case, the actual changes of increased or decreased revenue occur without a rate proceeding. This type of adjustment mechanism is usually made directly to a customer's bill and accounts for deviations from normal weather. It will reward customers when weather is colder than normal while protecting the utility when the weather is warmer than normal. *See e.g., Re Kansas Gas Service Company, a Division of ONEOK, Inc.,* Docket No. 01-KGSG-229-TAR, 205 PUR4th 365, Kansas State Corporation Commission, October 2, 2000. According to a survey conducted by the American Gas Association, weather normalization clauses have been reviewed and approved in at least 19 states. Admittedly, some states do not permit these types of clauses. *Regulatory Strategies and Innovative Rate Trends*, Cynthia Maple, American Gas Association (Aug. 17, 2005).

Decoupling Tariffs and Margin Recovery Tracker Mechanisms: A decoupling tariff and margin recovery tracker is designed to “decouple” a change in sales or transportation of natural gas with a change in profitability. The goal of such a mechanism is to achieve a modest periodic rate adjustment (i.e., outside a rate case) to “decouple” recovery of the utility's authorized fixed costs from unexpected fluctuations in retail sales. A recent survey of states conducted by the American Gas Association shows that the Commissions in Maryland, Oregon, and California have approved such a mechanism. Other states (i.e., Arkansas, Washington, Arizona, and Minnesota are considering applications for approval. Nevada's Commission has

denied a request by Southwest Gas for approval of this mechanism. *See, e.g., Re Northwest Natural Gas Company, UG 143, Order No. 02-634, 220 PUR4th 91, Oregon Public Utility Commission (September 12, 2002).*

While this type of mechanism is similar to Aquila's LCR application, decoupling and providing for a tracker mechanism is not the intended format for Aquila's LCR application. The main point of these cases are to demonstrate that other states with regulatory acts and concerns review and approve rate proceedings that adjust revenue outside of traditional rate proceedings.

Conservation Riders, Revenue and Return Stabilization and Expense Trackers:

These types of mechanisms vary in design, but are intended to either stabilize a utility's revenues or provide more timely recovery of expenses outside of a traditional rate proceeding. They are numerous and vary in design by state.

FERC: The Federal Energy Regulatory Commission also allows revenue or expense recovery mechanisms outside of a general Natural Gas Act section 4 proceeding. *See, e.g. ANR, 110 FERC ¶ 61,069 (2005)*(modified policy to require a true-up mechanism as part of all tariff provisions permitting adjustments to cost items outside of a general section 4 rate case.)

Make-Whole Proceedings: Some states have gone so far as establishing what is referred to within the utility industry as "make-whole" proceedings. For example, the State of Kansas, which Nebraska modeled the State Natural Gas Regulation Act after, permits "[A]ny utility that proposes a change in rates within 12 months after a commission order following a General rate proceeding and investigation may submit schedules eliminating data that duplicates information provided in the original schedules if both of the following conditions are met:

- (a) The utility is willing to adopt all the regulatory procedures, principles, and rate of return established by the commission in that order, and

- (b) The utility receives prior approval from the Commission. *See K.A.R § 82-I-231(b)(3) (2005).*

The state of Colorado also permits make-whole proceedings. *See, e.g., Re: Investigation and Suspension of Tariff Sheets Accompanying Advice Letter No. 290, filed by Peoples Natural Gas, Division of Internorth, Inc., for Revision of Colorado PUC No. 1 – Gas, Docket No. 1448, Decision No. R80-2379 (Colo. PUC 1980)(authorizing a “Make-Whole” revenue increase.).*

A make-whole case is designed to follow a recently adjudicated general rate case, in which the rates of return and major regulatory principles and accounting adjustments have been resolved (e.g., capital structure, ROE, year-end vs. average rate base, working capital, and etc.).

In the make-whole filing the utility updates the rate base and income statement exhibits for a more recent test year, while using the same returns and regulatory principles adopted by the utility commission in the last general rate case. Since the filing is not a full-blown general rate case, the amount of pre-filed testimony, of witnesses, and exhibits is limited, when compared to the general rate case. A utility just addresses the facts that are relevant to the make-whole, like adherence to the returns and regulatory principles established in the recent general rate case, the updated financial exhibits to the new test year, and the updated revenue requirement and rider needed to collect the revenue increase.

The revenue increase granted in a make-whole is usually put into place by a uniform percentage rider. There usually are no cost of service and rate design components of the make-whole filing.

Summary of Other State Case Argument: While Aquila could cite and thereafter present a brief of case upon case upon case from other jurisdictions in support of its position, it

relies instead on the main point of its argument. That point is that other state commissions have approved rate and tariff mechanisms that produce revenue that are not established in a traditional rate proceeding. Those state regulatory models are not entirely different than Nebraska. Aquila's request for an LCR without following the strict requirements for General rate filings set forth in section 66-1838 of the State Natural Gas Regulation Act holds merit, and is not dissimilar to revenue generating activity in other states.

As Aquila acknowledged in its application, LCRs are not common in other states. There are numerous reasons why another state might reject or deny the use of such a mechanism. However, as also pointed out by Aquila in its application, the Commission possesses broad powers under Nebraska law to approve an LCR without conducting a General rate filing. Not only is there a legal basis for authorizing Aquila's LCR, there are significant policy reasons that support an LCR application. Many of those policy reasons justify approval of an LCR in Nebraska where such a request may not apply in other jurisdictions. Aquila will address its policy reasons below.

III. POLICY REASONS FOR APPROVING AQUILA'S RECOVERY

Aquila's request for approval is supported by public policy too. The bottom line for approving Aquila's use of Limited Cost Recovery mechanism is that it will benefit Aquila and its customers. An LCR is intended to limit the drain on the Commission resources too. Much of the policy argument supporting Aquila's LCR filing was presented in Aquila's LCR application. Those arguments will be presented below for convenience, and in support of Aquila's continued argument in favor of permitting its LCR application on policy grounds in addition to legal grounds.

Aquila's Limited Cost Recovery Filing

One of the reasons of Aquila for filing its LCR application pursuant to sections other than the General rate filing provisions of the Act is to avoid the time and expense on all parties required by the General rate filing statutes. The Act provides for alternative rate making ability authority for actions other than a full blown rate proceeding. This application for limited cost recovery is such an action.

Benefits of Limited Cost Recovery ("LCR")

Aquila believes that its application for limited cost recovery should be granted for a number of public policy reasons. Permitting a rate change and thereby allowing recovery of additional costs by Aquila is in the public interest, and if successful should provide benefits to all stakeholders of Aquila: Regulators, Customers and Shareholders. As noted in its LCR application, a primary goal of Aquila's LCR is to present a win, win, win scenario. Some of the benefits intended and realized by Aquila's LCR are as follows:

1. Customers will realize a projected annual increase in their Customer Charge in this case of only \$.47 per month versus the monthly Customer Charge increase of \$3 to \$5 per month every third year reasonably projected under a fully litigated (i.e., General) rate

proceeding. Smaller increases are more readily affordable by Aquila's customers than are larger, infrequent cases.

2. Lower regulatory and litigation cost to customers to attain just and reasonable rates. This lower cost will result from eliminating the level of discovery, testimony, evidence, and human resource allocation on a number of disputed issues typically reviewed during a general rate case. The LCR process must limit the scope of review or defense of the recovery of cost increases for this benefit to be realized.

3. LCR rate filings allows for more timely recovery of increased costs. This more timely recovery may permit Aquila to avoid filing a General rate filing application for a period of time longer than the three to four years that traditional rate making normally permits.

4. To decrease the frequency of general rate cases from every 3-4 years to every 5 to 7 years, depending on how well the LCR mechanism actually tracks utility costs. Limited Cost Recovery rate changes should decrease the size of or delay the need for full rate case filings.

5. LCR rate changes allow Aquila to remain more competitive in its largest service areas with its primary competitors because Aquila bears burdens and expenses that MUD and Public Power entities in Nebraska do not bear.

Potential Risks of Limited Cost Recovery

Obviously, the rise of costs in the future for any or all expenses or investments incurred as a result of Aquila's duty to provide safe and reliable utility service at just and reasonable costs cannot be predicted with certainty. Because of that uncertainty, the benefits listed above, while reasonably anticipated, cannot be guaranteed.

To that potential risk, Aquila notes and identifies below where it believes that the goals and benefits of Limited Cost Recovery may not be realized. Those circumstances are as follows:

1. Limited Cost Recovery is already limited to utility accounts not likely to create disputes, and then reduced further to avoid all remaining dispute, and thereby prompt favorable and fair treatment of the requested reduced increase. If significant issues or procedures further dispute these few remaining items, then the anticipated litigation savings and limited cost recovery may not be realized. In other words, any further reductions from legitimate, requested expenses included under the Limited Cost Recovery filing may eliminate or severely hamper the mutual benefit and value of the Limited Cost Recovery approach.

2. Limited cost increases that are too low will not substantially reduce the need for full rate cases nor decrease the frequency of filing. The Limited Cost Recovery does not increase rates for all types of cost increases. Any reductions to the LCR during the process will add to the cost increases that could trigger when a General rate filing is needed.

3. As an example, an LCR increase of \$1.1 million annually (compared to the \$1.7 million justifiable on limited issues based on history) results in an annual shortfall of \$.6 million. This \$.6 million is added to the cost increases created by areas outside the scope of the LCR (like rate base increases or disputed issues such as variable compensation). In determining the need for a full rate case, the larger the accumulated shortfall, the more likely a general rate case becomes. If requested LCR filings are denied or reduced, then the shortfall becomes greater, and general rate case filing is more likely.

4. If litigation costs are excessive or data requests are non-germane to the streamlined scope of the LCR, the benefit of reduced litigation costs to customers and participants will not be achieved. The LCR is based on minimal litigation costs and efforts in exchange for voluntarily reducing the request and eliminating likely disputed areas.

Structure of Limited Cost Recovery Application

Aquila's Limited Cost Recovery application incorporates three completely different valuation methodologies to validate this alternate form of rate making. The purpose and intent of these valuation methods is to assist the Commission with its review, and to ensure that Aquila's request for limited recovery of its cost increases are fair and reasonable. Aquila's Limited Cost Recovery application requests a change in its rate that produces an increase of existing revenues of \$1,057,936. This increase was based, in part, on use of the Consumer Price Index ("CPI_U"). The CPI_U is a generally recognized standard of cost increases on a overall basis, and is the most readily available of all the possible indices. It is generally viewed as the broadest measure of cost increases, is simple to administer, and is widely understood as a surrogate for overall cost increases.

Aquila opted for this simple and easy to understand rate mechanism, recognizing that the other three measurements for comparison were all over 50% higher than CPI-U approach. Because Aquila is proposing a change in rate approach to cost (and not attempting to review overall revenue requirements in detail), it was not necessary or more accurate to attempt to match each individual category of costs with an inflation index of some type.

Aquila has included the following alternate valuation methods to which Aquila's request may be compared:

1.	Average Annual Rate Case Increases of Aquila:	\$1,802,502
2.	Telecommunications Statutory Standard (1% of Revenues):	\$1,581,131
3.	2004 Cost Based on 2003 Rate Case Outcomes	\$1,690,717

These different valuation and comparison methodologies effectively demonstrate how much Aquila might reasonably expect to increase its revenues if that particular method, and the associated statutory procedures required by it, were followed.

For example, if Aquila filed a General rate proceeding as it has in the past, and then was permitted the same or average level of recovery of its cost as it historically has realized from Nebraska regulators, Aquila would be granted an increase of \$1.8 million dollars. These three methods demonstrate that Aquila's limited cost request of \$1 million is substantially less than it could justify under more traditional and established rate making methodologies. A more complete numerical review of each methodology along with supporting underlying documentation supporting those methodologies can be found in the Exhibits attached to the LCR application.

Aquila filed its last General rate application in June 2003. The Commission approved and adopted a Stipulation and Agreement of Settlement between Aquila and the Public Advocate in early 2004. During that procedure, Aquila's legitimate utility expenses were thoroughly reviewed by this Commission. Accordingly, this Commission has a jurisdictional basis for determining whether an LCR is fair and reasonable.

Arguments In Favor of LCR

Aquila recognizes that it will be less burdensome on its customers to request smaller, more frequent changes in rates that produce increases of revenue instead of one larger General rate filing requests.

The rate change methods used by Aquila through its LCR filing are based on historical and current reviews. For example, the "Average Annual Rate Case Increases of Aquila" method looks only at the result of settled issues on all accounts raised in a General rate filing. Thus, that

method automatically reflects the settlement of prior disputed issues from reviews of all accounts. Granting an increase based on this method automatically reflects the issues that would otherwise be fully litigated in a General rate proceeding.

The “Telecommunications Statutory Standard” (i.e., 1% of Revenues) method is the same approach that the Nebraska Legislature has authorized for rate increases for telecommunication companies. This method acts as another validation method for reasonableness so that the Commission may assure itself and the public that just and reasonable rates result from this alternative ratemaking approach.

The “2004 Cost-Based on 2003 Rate Case Outcomes” looks at Aquila’s most recent General rate proceeding and applies the settlement of that proceeding to Aquila’s current utility accounts to determine what Aquila might expect if it were to file a new General rate increase application. This method (like the historical pattern of rate increases) by design does not include disputed issues or costs since it deals with only the settled amounts after a review of all accounts.

Use of the Consumer Price Index represents another measure of the current inflationary impact on goods and services used by Aquila in providing service to its customers.

The Commission may have concerns that other commissions around the country do not commonly address LCRs. However, this Commission understands from its long-time authority over telecommunication and other utilities that an LCR may be a more reasoned approach than the traditional statutory rate making procedures adopted by other states. There are several other reasons specific to Nebraska that justify an LCR even if other states do not routinely encounter such requests. Some of those reasons are presented below.

One factor that distinguishes Nebraska from other state regulatory schemes is that electric regulation in Nebraska is significantly different from other state regulation. For example,

Nebraska has adopted an electric service system that is entirely publicly owned in Nebraska. Nebraska has established exclusive service territories for those Public Power Districts, and permitted the elected Power District Boards to regulate those Power Districts. The Public Service Commission does not possess jurisdiction over any electric matters, Public Power District Board decisions, or their exclusive service territory. All other state Public Service Commissions possess extensive jurisdiction over electric service providers within their state.

Most other state Commissions regulate electric companies and have larger utility staff available to review numerous, comprehensive rate proceedings. Regulation of gas utilities are for convenience generally lumped into the regulatory regime set up for electric utilities.

Unlike the Public Power Districts, jurisdictional utilities do not enjoy exclusive service territories under existing Nebraska statutes. While Aquila is prohibited from entering into electric service areas and compete with Public Power, it still must compete for developments against those self-governing bodies. Those entities don't undergo regulatory scrutiny like that applied to Jurisdictional Utilities. An LCR should help Aquila gain some regulatory efficiency and eliminate costs, thereby allowing Aquila to better compete with Public Power in Nebraska. The more lenient regulatory models for Public Power justify alternative rate mechanisms for Aquila.

Another distinguishing factor in favor of LCRs is that this Commission does not regulate one of the largest natural gas utilities (i.e. Metropolitan Utilities District of Omaha or "MUD") which serves the largest city in Nebraska. MUD and its elected Board of Directors set the rates, terms, and conditions of service for its customers. MUD is not restricted to a specific service territory except as may be limited by Nebraska law preventing double piping and redundant service. See, e.g. Neb. Rev. Stat. § 57-1301, et. seq. MUD is aggressive in its growth strategy.

It does not undergo any independent or separate outside review of its rates, terms or conditions of service even though it competes for service territory with Jurisdictional Utilities. MUD's encroachment into the traditional service territory of Aquila causes harm to Aquila and its customers since economies of scale are lost each time a customer who would have applied for service at Aquila hooks up to MUD's system. The more lenient and less expensive regulatory model applied to MUD in Nebraska justifies approving an LCR for Aquila.

Aquila recognizes that until MUD is under the same regulatory scheme, and subject to the same regulatory rules and regulations that apply to Aquila there will be significant competitive advantages for MUD. However, because the State Natural Gas Regulation Act does permit alternative rate making authority for the Commission, an LCR will mitigate some of the regulatory lag and regulatory costs to reduce some of the regulatory competitive advantage that inures to MUD under current Nebraska law. To Aquila's knowledge, no other state permits an entity like MUD to self-govern and then operate in self-defined, practically unlimited, boundaries. This significant difference in natural gas regulation among otherwise equal competitors justifies regulatory approaches that may not be present in other states.

Another reason supporting an LCR filing is that this Commission did not assume responsibility for investor-owned (i.e. jurisdictional) natural gas regulation until July 2003. Previously those entities were regulated by Nebraska Municipalities under the Municipal Natural Gas Regulation Act, Neb. Rev. Stat. §§ 19-4601 et. seq. (Repealed).

The Municipal Natural Gas Regulation Act was aimed mainly at rate case procedures. It did not contain much, if any, language about alternative rates and non-traditional rate making procedures. The State Natural Gas Regulation Act on the other hand does contain Commission authority to look at negotiated rates. Neb. Rev. Stat. § 66-1855 et al. (2003). This Commission

can look at the entire service territory of Aquila and may apply a state-wide perspective versus the prior act which ultimately allocated costs at a local Municipality level. An LCR is designed to reduce or otherwise avoid costs that may otherwise be incurred through traditional rate making approaches.

The last reason to be presented in this document for adopting an LCR approach is a pragmatic one. Other states do not have Nebraska's and this Commission's experience in particular with telecommunication utility deregulation in providing for the best interests of the Customers. Adhering strictly to a regulatory model whose choices are between General rate applications or nothing may not be in the best long-term interests of Aquila or its customers. In other words, this Commission can determine it may be better for customers to pay a small increase than having to absorb a significantly larger increase less frequently.

CONCLUSION

WHEREFORE, for all of the foregoing reasons, Aquila requests that the Commission approve its application to continue its Limited Cost Recovery. Approval of Aquila's request is supported by authority set forth in the State Natural Gas Regulation Act, supported by public policy, and consistent with other jurisdictions who have addressed this type of request. Specifically, the state of Kansas, from which Nebraska adopted much of its regulatory statutes also approved similar authority for Aquila.

Respectfully submitted,

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CERTIFICATE OF SERVICE

The undersigned hereby certifies that on the 7th day of October, 2005, a true and correct copy of the foregoing *Brief of Aquila, Inc. d/b/a Aquila Networks* was served upon all parties by depositing a copy of the same in the United States regular mail, postage prepaid and properly addressed, to the following:

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